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TESTIMONY OF THE HONORABLE EDWARD K. THOMAS
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Oversight Hearing on Contract Support Cost Issues

Before the U.S. Senate Committee on Indian Affairs

September 15, 1999

INTRODUCTION

GREETINGS FROM ALASKA! My name is Edward K. Thomas. I am the elected President of the Central Council of Tlingit and Haida Indian Tribes of Alaska, a federally recognized Indian tribe from Southeast Alaska with over 23,000 members. I have served as the elected President of my Tribe since 1984.

Thank you for the opportunity to testify at this Oversight Hearing on the crisis confronting my Tribe as a result of the calculation and underpayment of indirect costs, also known as Contract Support Costs (CSC), by the Congress and the Administration. My testimony will focus on the programs my Tribe operates with funding from the Bureau of Indian Affairs (BIA).

BIA CSC FUNDING SHORTFALLS CHOKES OUR OPERATIONS

For the period between 1996 through 1999, the BIA failed to deliver to us a total of \$953,781 in contract support cost funding which its own negotiators, applying uniform federal rules, had determined were due us for our operation of BIA-funded programs. This \$953,781 is what we call our shortfall. This is non-federal money we had to pay from the earnings on our Tribal Trust Fund. The expending of these dollars to replace the federal government's contractual obligations have resulted in lost opportunities to address the many problems facing our people whose unemployment rates are on the average twice that of an unemployment rate during a depression.

Simply put, the way indirect costs are calculated and paid by the United States creates an ever-tightening chokehold on my Tribe's ability to administer programs. If we follow the law and spend what we must, we receive less money to meet these expenditures. The more we spend, the less we get. The less we spend, the less we get. As I set out in greater detail below, both Congress and the BIA have caused this crisis. Together we can solve it.

In the early 1990s, Central Council took the first possible opportunity to fully assume the operation of all programs, functions, services and activities previously provided to us by BIA employees. We were one of the first ten tribes in the self-governance demonstration project. In our first year, we took over and completely closed down one entire unit of the federal government -- the BIA's Southeast Alaska Agency Office.

Throughout the past decade, our BIA contract support costs have been severely underfunded. In 1996 we recovered only 87% of our contract support need. This meant we faced a 1996 shortfall in funding of

\$129,418. We did not learn about this shortfall until about halfway through our program year. Leases had been signed. Purchases made. Employees hired. We were well into our budget year, with expenditures meeting plan when suddenly we were told that the equivalent of about six weeks of operations would be unfunded. We were forced to pull \$129,418 out of our modest Trust Fund earnings in order to meet the costs we were stuck with by the United States.

Our Trust Fund is what remains of a judgment fund provided to us in exchange for land taken from our Tribe. We have pledged to our membership that we will jealously guard and preserve the principal, and endeavor to reinvest as much as possible of its earnings in order to not have the value of the principal erode due to inflation. It is not the purpose of the Trust Fund to use the interest it has earned to make up for sudden losses created by the United States. The choice we faced at the end of 1996 was either to shutdown all of the vital services we provide our membership, shutter our offices, layoff employees, and pay for early termination of contracts, or to dip into our Trust Fund earnings to maintain operations. We chose to continue.

In 1997, BIA again notified us mid-way through our budget year that it would send us only 77% of our BIA-generated contract support funding requirements. This amounted to an actual under-recovery of \$299,287, nearly one-fourth of our annual, BIA-approved budget. Again, we were forced to redirect our limited non-Federal funds so as to permit our operations to continue.

Halfway through 1998, BIA notified us our payment be only 80% of our contract support need. This amounted to an actual shortfall of \$302,400.

And earlier this year, the BIA informed us that available funding permitted BIA to send us only 88% of the indirect costs associated with our operation of BIA-funded programs, creating a 1999 shortfall of \$222,676. Again, we were forced to reallocate Trust Fund earnings to make up for the difference.

The \$953,781 shortfall in BIA contract support funds due Tlingit Haida has placed a great deal of financial stress on our Tribe. It has forced Tlingit Haida to draw over \$400,000 out of our original judgment Trust Fund, an amount that otherwise would have significantly boosted the Fund's growth during the recent expansion of the stock market. In addition, the use of these Trust Fund dollars to make up for under-recovery of BIA contract support funding has made it very difficult for Tlingit Haida to provide other critical membership services that Trust Fund dollars have been used for in the past.

In addition to the diversion of our Trust Fund earnings, the shortfall in BIA contract support funding has been felt throughout Tlingit Haida. As an immediate result of this shortfall, we have had to lay off employees who are also tribal members and in desperate need of employment. In a time when staff training is critical to handle the quickly changing advances in technology, the BIA shortfall has made it necessary for us to reduce and even eliminate many training opportunities. Unlike many of the federal agencies from whom we receive grants and contracts, the BIA shortfall has forced us to stop giving merit-based increases in compensation to our most valuable employees. The BIA shortfall has also caused end of year cash-flow management problems making it difficult for us to meet payroll and causing delayed payments on some accounts payable and quarterly retirement payments.

INDIRECT COSTS ARE FIXED COST REQUIREMENTS

If indirect costs were not primarily "fixed" costs, the recurring problem of a shortfall in BIA contract support cost funding would, perhaps, be survivable. But most of our actual indirect costs are "fixed". For example, typically the most cost-effective way to acquire facility space or equipment is through a long-term lease with locked-in costs. Similarly, package deals for telephone and some forms of transportation offer significant cost savings over time. And obviously, the salary and benefit costs of accounting, administrative, and management staff must be treated as "fixed" or else we cannot hire or keep employees. If BIA does not send us 100% of the funds required by our rate, we have a shortfall associated with our operation of BIA programs.

We refer to tribal indirect cost funding as a "requirement", not a "need". They are requirements because they are derived from negotiations over rates that are used uniformly by federal agencies with all contractors, including universities and the defense industry. The rates use actual expenditures from prior years to project costs in the future year. Once set, the rates must be applied uniformly to all our programs.

Let me be clear about something. We would spiral into bankruptcy if we chose to not spend at the budgeted amounts. Failing to pay certain fixed costs would actually increase our costs (breaking leases, terminating employees, breaching contracts). Deferring certain costs to the following year aggravates the hardship of the shortfalls that cripple that year. And while to a limited extent, the P.L. 93-638 protections against theoretical under-recovery do work with respect to BIA funds; they still do not cushion our Tribe from the difficulties of dealing with shortfalls in non-BIA programs for which we must, by law, use the same indirect cost rate. If in year one we don't spend uniformly on all programs, BIA and non-BIA alike, this will lower the rate negotiated for the following year because the rate must be based on actual expenditures for the prior year. That lower rate is applied across the board to all programs, BIA included. When the BIA "requirement" is calculated by the rate, the BIA then applies an additional reduction to reflect the pro rata shortfall in appropriations earmarked for the contract support cost fund. The bottom line is that our bottom line gets smaller and smaller, year after year while our expenses remain steady or rise with inflation.

TLINGIT HAIDA'S ADMINISTRATIVE COSTS ARE KEPT TO A MINIMUM

I am proud to report that the Central Council has, year after year, restrained the pressures to increase its administrative spending. We have maintained increased below the national rate of inflation, despite the fact that our unemployment rates are exceedingly high and the resulting pressure from our membership is to make job creation the priority above all other program and service priorities. What follows is a chart we annually provide to our tribal membership that shows our revenue growth and administrative constraint:

TLINGIT HAIDA TARGETS ITS INDIRECT COST RATES TO SAVE FUNDS

Some time ago, Tlingit Haida determined that the use of multiple indirect cost rates would provide for better accuracy in the allocation of indirect costs throughout our organizational delivery system. Multiple rates reflect the actual administrative burden generated by various grants and contracts. This burden includes utilities, office space costs, executive direction, accounting and all other overhead costs that benefit all grants and contracts equally. We have used three classifications of direct expenditures made in our grants and contracts. Each of these direct expenditure classifications requires a different level of administrative effort and cost; therefore, a different indirect cost rate is applied for each one.

The first of our three rates is called our "passthrough" rate and consists of direct funding that passes through Tlingit Haida to a separate and independent non-profit organization or government that both expends and accounts for the funding and most of their own overhead-type expenses. The administrative burden Tlingit Haida carries in this type of arrangement is sharply reduced, so our current passthrough indirect cost rate is only 7.1 percent.

The second of our three rates is called our "offsite" rate and is applied to direct funding accounted for by Tlingit Haida but expended at locations where some costs such as utilities and office space are funded through an independent tribal government and not by Tlingit Haida. In this case, Tlingit Haida has more administrative burden than with passthrough funding but not all indirect costs are covered by Tlingit Haida. Currently our indirect cost rate for offsite expenditures is 13.2 percent.

Our third indirect cost rate classification is called our "onsite" rate and is applied to direct expenditures that are both expended and accounted for by Tlingit Haida. Direct expenditures under this classification are fully supported by Tlingit Haida and include all utilities, office space, executive direction, accounting and all other overhead costs that benefit all grants and contracts equally. Since Tlingit Haida carries the full administrative burden for this classification of direct expenditures the indirect cost rate is at 38.5 percent.

It is our understanding that, when our three rates are blended together they result in a rate that is well within the average range of tribal indirect cost rates.

THE SOURCES OF THE BIA CSC SHORTFALL PROBLEM ARE OBVIOUS

There are several reasons why we have the present shortfall crisis in BIA contract support funding. The GAO study released in June of this year details them in adequate fashion. I wish to focus on three additional factors.

More than a decade ago, Congress and the Administration set up a separate appropriations account for indirect costs associated with the operation of tribal contracts under P.L. 93-638. However, no companion account was set up to identify the direct funds under tribal contracts, in large part because of bureaucratic pressure to obscure the relatively small amount of BIA funds being transferred into tribal contracts at that time. Consequently, annual budget requests for the contract support cost fund have lagged far below required levels, apparently because federal agency officials view as a threat to their job security and spheres of influence the devolution and transfer to tribes of federal programs, functions, services and activities under P.L. 93-638. In other words, direct and indirect funds were "de-linked" some time ago and no attention was paid to how out of proportion they were becoming. If there had been a separate account in the budget structure that contained the direct funds identified to tribal contracts and compacts, the shortfall problem would have been more apparent at an earlier stage of the process. Even at this late date, such an account would serve a useful purpose.

Another factor lies in the variation of tribal indirect cost rates approved by the United States. While the indirect cost rates are uniformly applied, the nature of the rates, and what costs they do and do not cover, varies widely from region to region and tribe to tribe. There is something to be said for the specific and unique factors that each tribe brings to the negotiation table that would allow for some variation. But the fact that some federal negotiators routinely classify certain costs as allowable indirect, and other costs as not, creates a crazy quilt practice throughout Indian Country which in part produces a wide range of very high and very low rates. Tribes who receive nearly all their revenue from BIA and IHS sources, and tribes who have non-federal resources from tribal revenues at their disposal, both have an incentive to classify more costs as indirect, thereby hiking their rates and obtaining higher shares of contract support funds even with the shortfalls. Tribes like Tlingit Haida who receive funding from a variety of sources in addition to the BIA, but have little or no tribal revenues, have no such incentive but also have no ability to make up the difference from the shortfall.

And finally, there has been some misinformation about the extent and future nature of the "problem". The GAO study I referred to earlier helps makes this clear. Between 1989 to 1998, the growth in actual funding of "indirect" costs by BIA and IHS was less (224%) than the growth in "direct" cost funds placed in contracts and compacts (238%). Moreover, the GAO report indicates that the actual amount of indirect costs funded comprised 22.1% of the total of "direct" costs that are in IHS and BIA contracts and compacts. That average tribal administrative cost "rate" should go down as more and more tribes take on more and more programs, since tribal operations already include accounting, payroll, procurement and management systems that could handle added workloads more efficiently. In other words, these systems are in place in most tribal government operations. If these tribes take on more work, the cost efficiencies of their management systems will increase, resulting in a reduction of overall indirect cost rates.

THE BIA CSC SHORTFALL IS A SOLVABLE PROBLEM

In recent years, the problems of shortfalls in BIA and in Indian Health Service (IHS) contract support cost funding have been lumped together and addressed as one. While BIA and IHS shortfalls are similar, the BIA portion of the problem is much smaller. The roots of the BIA problem are different from the IHS problem. And the path to resolution of BIA shortfalls may be easier than fixing the IHS shortfalls, given that there are fewer big BIA than IHS operations waiting in line to be placed in contracts or compacts. I would urge this Committee and the appropriations committees to address the IHS and BIA problems separately, and give priority attention to fixing the resolvable BIA problem first.

Relatively speaking, the bulk of the problem of the BIA contract support cost shortfall can be fixed for many Tribes without requiring huge outlays of additional funding. My Tribe's shortfalls are comparatively modest, about \$250,000 per year. Within the overall Federal appropriations, this is a small drop in the bucket. For our tribal budget, however, our shortfalls can represent as much as three months worth of operational costs in any given year. Surely the Congress can find sufficient funds to remove this relatively small shortfall on a permanent basis in an era when the United States spends millions of dollars to painstakingly investigate whether this or that public official fudged the truth when other public officials think they should not have, when our Nation spends billions of dollars on peacekeeping operations surrounding the globe, and when we spend hundreds of millions of dollars in emergencies relating to budget cap miscalculations as well as natural disasters at home and abroad. Our problem looms large for us. But it could be fixed with a relatively small reallocation of federal funds. All other federal contractors receive 100% of their allowable indirect costs under similar rates negotiated with the United States. Our appropriations should be adjusted to provide us with similar full funding treatment.

The present way of calculating indirect cost rates provides little incentive to some tribes to make their operations efficient. Whatever changes are made to contain the range of rates or to apportion limited funding should take into account the need to protect the most efficient tribal operations first before addressing what appear to be the less efficient ones. As you know, recent lawsuits have resulted in the Congress attempting to place a "cap" in the appropriations law on the amount that BIA is authorized to provide out of the lump sum appropriation regardless of the contract support cost requirements negotiated with the federal Inspector General's office. This inflexible "solution" provides no incentive for tribal administrative cost efficiency.

As you prioritize how you might begin to fix the problems, I would urge upon you several principles:

1. Give priority to fixing the resolvable problems at BIA first.
2. Fully fund allowable costs arising from negotiated rates.
3. If there are limited funds or rates are capped, prioritize the funding of tribal administrative efficiency.
4. Create a new appropriations account for direct funds in contracts or compacts, by which growth in contracting or compacting can be monitored and linked to the already established contract support cost fund.

THANK YOU

Thank you very much, Mr. Chairman and Members of the Committee, for the opportunity to present this testimony on behalf of Central Council of Tlingit and Haida Indian Tribes of Alaska and its citizens we serve. I commend you and this very distinguished committee for the valuable time you are dedicating to this very important issue. I wish you well as you do your work in this Congress and I hope my comments are useful as you consider these very important issues. The contract support cost problems can be resolved and I urge you to first address the BIA shortfalls as the most readily achievable of the solutions.